

Defense Science Board Task Force Report

FY 1994-99 FUTURE YEARS DEFENSE PLAN

PART II

MAY 1993



OFFICE OF THE UNDER SECRETARY OF DEFENSE
WASHINGTON, DC 20301-3140

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OFFICE OF THE SECRETARY OF DEFENSE
WASHINGTON, D.C. 20301-3140

DEFENSE SCIENCE
BOARD

29 JUN 1993

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (ACQUISITION)

SUBJECT: Report of the Defense Science Board Task Force on FY
1994-99 Future Years Defense Plan (Part II)

I am pleased to forward Part II of the Defense Science Board Task Force Report on FY 1994-99 Future Years Defense Plan. As you know, the Task Force was chaired by Mr. Philip Odeen and also included Mr. Jeffrey H. Smith and Mr. E. C. "Pete" Aldridge, Jr. as participating members in the effort.

As the Task Force Chairman points out in his covering memorandum, this report provides comments on the following two areas:

- Adequacy of the O&M funding to support the baseline force structure.
- Health care costs.

This report completes the analysis of all the issues contained in the original Task Force Terms of Reference. I recommend that you review the findings and recommendations contained in the report and forward the report to the Secretary of Defense.

A handwritten signature in cursive script, likely of Paul G. Kaminski, is positioned above the typed name.

Paul G. Kaminski
Chairman

Attachment



OFFICE OF THE SECRETARY OF DEFENSE
WASHINGTON, D.C. 20301-3140

May 28, 1993

DEFENSE SCIENCE
BOARD

Memorandum for the Secretary of Defense

Subject: Review of the Funding of the Bush FY94-99 FYDP

In our memorandum of May 3, 1993, we provided you with our assessment of the adequacy of funding in the Bush FYDP in several key areas; DMRD savings, weapon system costs, and environmental costs. We also provided comments on the potential of a procurement "bow-wave" in the period beyond FY99. This memorandum provides comments on two other areas; the adequacy of the O&M funding to support the baseline force structure and health care funding in the Bush FYDP.

Our conclusions in this memo are qualitatively different from those in our earlier memo. Although we see problems of real consequence in these areas, we feel the solutions are management related and need to be addressed in the current "bottom-up" review and related studies and decisions. The two issues are discussed below.

A. Funds to Support Major Forces and Programs

1. Background

The Panel reviewed the Bush FYDP to determine if funding for O&M personnel, and related activities was adequate to support the Bush baseline force structure. The primary issue is O&M funds--their adequacy to maintain readiness at needed levels, fund a decent quality of life for our people, and maintain the DOD infrastructure at acceptable levels. The FY93 O&M budget totals \$86 billion and was projected to decline to \$80 billion by FY97 in the Bush FYDP'. In recent years, Congress has not generally cut O&M funding directly, but it frequently takes other actions which have the same effect, e.g. assuming European burden-sharing payments or increasing DBOF cash transfers. (Such actions in FY93 accounted for an effective cut of four percent in O&M fundings.)

The O&M account has been spared the deep cuts that impacted the procurement account. For example, the Clinton FY94 O&M budget request of \$89.5 billion is larger in current dollar terms than the levels in the late 1980s when the Defense Budget was much larger (\$300 billion). In constant dollars (i.e., real terms) the FY94 Budget is only 14 percent below the peak level of 1985 while the procurement account is down over 70 percent. Only the RDT&E account fared better. O&M consumes 34 percent of the total FY94 DOD Budget Authority request compared to 29 percent in FY89 and 26 percent in FY85. Given these trends, it is difficult to argue for allocating more Defense spending to O&M

The Services all told us that readiness-related operations (flying and steaming hours, training, etc.) are funded adequately. However, they admit that such areas as facility and base maintenance and repair are not as well supported. Moreover, other programs such as DMRD and DBOF impact the O&M

'The Clinton FY94 O&M Budget totals \$89.5 billion, a slight increase over the Bush budget proposal.

accounts and add to the uncertainty of the adequacy of the Bush FYDP funds. Should the planned efficiency improvements not succeed or cash fail to be generated by the DBOF to transfer to the Service O&M accounts, readiness would likely be impacted. Unfortunately, measuring readiness is not easy, the existing measures are input oriented, and the linkage of O&M funding shortfalls to readiness is a very imprecise science, at best. In short, O&M is a large pot of money (34 percent of the DOD budget and growing), managed in a decentralized way, that is critical to the readiness and effectiveness of our forces.

2. Findings

Many of the Panel's concerns regarding O&M funds relate to the DMRD and DBOF issues discussed in our earlier memo. Problems in these programs could cause significant shortfalls in Service O&M accounts. In fact, such problems may have contributed to the issues discussed below. Over the course of the briefings, all three Military Departments stated that the FYDP provides adequate O&M funds to support the readiness of their forces. (We have some concern that this optimistic assessment may have been made to preclude a Secretary of Defense directive to "fix" O&M at the expense of additional force structure or modernization reductions.) On the other hand, all the Services stated that they were not programming adequate funds for base and facility operations and repair. For example, the Army felt that its base support related O&M funding was inadequate by \$2 to 3 billion per year over the Bush FYDP. The other Departments had much lower estimates - roughly \$1 billion per year. These calculations were based on "requirements" driven by the current base structure and complex algorithms related to repair and upkeep frequency and costs.

In our extensive discussions of this issue (three formal meetings plus staff studies and other OSD and Service inputs), we realized that these problems primarily relate to decisions on the proper balance between structure, procurement, and operations. In the Army's case in particular, the briefers pointed out that they fully programmed the OSD/JCS mandated 'Base Force' structure in developing the FY94-99 Bush FYDP. Yet the approved top-line funding was inadequate, and as a result, they cut procurement deeply and did not fund adequate levels of base operations and maintenance. In your statement related to the "bottom-up" review that is underway, you noted the need for proper balance between various elements of the Defense program. The Bush Army FYDP illustrates of the impact of fixing force structure at levels that are not supportable with the available funds.

As noted above, the Bush FYDP O&M issues relate primarily to the adequacy of funds to support current bases and facilities. We believe that the physical infrastructure is much larger than required to support the future force structure. The current round of Base Realignment and Closure actions (BRAC 93) will help resolve this problem, particularly for the Navy. But further, aggressive BRAC actions must be undertaken as the planned Defense budget reductions proceed. Unless the base infrastructure is reduced, we will get either a "hollow" force or an even smaller force structure.

Another issue that frequently adversely impacted Service O&M funding was unplanned requirements (e.g., Somalia) or Congressional actions, that the Services were forced to "take money out of their hide" to cover. As

discussed in our first report, this problem has increased in severity as Service budgets are reduced and their flexibility is reduced. A related issue is the potential negative impact if the optimistic inflation assumptions used in the Bush FYDP are not realized and added funds are not provided.

3. Recommendations

To minimize the impact of O&M funding limitations on critical programs, in structuring the new FYDP, DOD should:

- Determine its long-term base structure and fund the Base Maintenance and Repair (BMAR) and Base Operations accounts for these bases at a healthy level. We must maintain the core bases at a high standard over the long-term both for reasons of quality of life and good management. Unneeded bases should be closed expeditiously. (Given the softness of the "requirements" data, OSD should strengthen and standardize the methods used to assess the adequacy of funding in the BMAR area.)
- Establish a more explicit system to relate the funding of operating accounts programs to the readiness levels and other output measures of force effectiveness. The linkage is currently too soft to make sound policy and budget choices. In this regard, we support your decision to appoint a panel of retired senior military officers to address this issue.
- Review the inflation assumptions used in the Bush FYDP and if warranted, use more realistic assumptions. Should the assumptions prove to be low, virtually every budget account would be impacted adversely.

We were unable to get a precise fix on the scope of any O&M underfunding over and above the DMRD and related problems discussed in our earlier report. However, we believe any shortfall is within an acceptable range and normal management actions and prioritization of available funds can meet the critical needs and maintain our forces at high levels of readiness. This assumes that DOD will continue to aggressively close unneeded bases and facilities and that steps will be taken to reduce the risks from unexpected contingencies, DBOF shortfalls, etc., as outlined in our earlier report. Nonetheless, in developing the new defense program we believe you will find you are not able to reduce O&M funding in parallel with cuts in forces because of the imbalance of the Bush FYDP. Moreover, properly managing the O&M accounts will consume a great deal of your time and that of the DOD senior management team

One other recent development could impact O&M funding. We note that the recently proposed energy (BTU) tax will increase the cost of many products that DOD buys. It is unclear how much of the tax on petroleum products DOD would have to pay. On the basis of present practice, DOD may not have to pay the tax on bulk purchases of jet fuel but would pay the tax on most other petroleum products. The direct cost to DOD of the BTU tax is estimated by the OSD staff to be about \$275 million annually after the tax is fully implemented in FY97. DOD also would pay an estimated \$300 million a year more by FY97 as the

BTU tax is passed forward in higher prices for energy intensive products. Altogether, the proposed BTU tax could increase DOD costs by over \$500 million by FY97, depending on the specifics of the tax bill that emerges from Congress later this year.

B. Health Care Costs

1. Background

DOD spends about \$14 billion per year (including military personnel costs), split roughly 75 percent for the in-house medical system and 25 percent for the CHAMPUS insurance program. While the active duty military population is being reduced, the retired population which has claim on DOD paid health care is growing and aging. DOD costs have increased six percent per year for the past five years and are programmed to increase eight percent per year through the FYDP period. The military health care system is influenced by the same factors driving up health costs in the U.S. economy. Congressional actions have put further pressure on costs by adding new benefits (e.g. dental insurance) or mandating more generous benefits such as the CHAMPUS Reform Initiative (CRI) which has increased CHAMPUS costs significantly in the West Coast test area. Efforts to reduce benefits or increase co-payments are opposed by the Services as undermining "quality of life" or breaking a "commitment," especially in this period of high career uncertainty for our military personnel. Congressional refusal to permit cuts in medical personnel creates problems as well - 24 percent of all Army officers are medical related, an astonishing figure.

2. Recommendations

Based on our discussions with OSD and Service representatives, the DOD Health Care program as presently constituted could be underfunded by \$200 to 400 million per year during the FY95-99 period. However, we believe DOD can live with the projected funding levels if the Administration and Congress are willing to take certain actions that parallel those being taken by the private sector which faces similar issues. The type actions required include:

- Continued aggressive management improvements to reduce delivery costs such as cuts in staffing, use of improved information systems, and better procurement practices.
- Ending costly special programs such as Enhanced CHAMPUS that provide benefits that exceed many private plans.
- Increasing deductibles and co-payments for active (except E-1 through E-4) and retired personnel. These are needed to reduce the non-essential use of costly medical services.
- Although it doesn't reduce Federal Government costs, DOD should bill Medicare for costs incurred by eligible recipients using the military medical system (as they bill private insurance carriers).

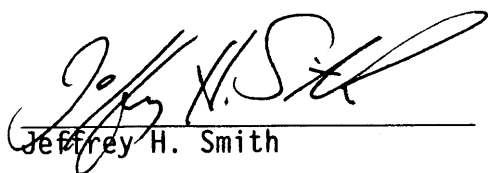
OSD is currently preparing a detailed review of the DOD Health Care Program. It will include an assessment of the wartime needs for military support as well as options for meeting peacetime military and dependent health care obligations. The results should provide ideas and directions that will permit DOD to manage its health care costs in a more efficient manner (e.g. reduce the military manpower involved), without undermining this important basic benefit. However, DOD must be alert to potential, costly repercussions from the broader reform of health care being considered by the White House and Congress. Changes that reduce the benefits under standard private sector plans could cause many eligible people who now forego CHAMPUS or in-house facilities to return to the military health care system. At present only about 50% of eligible personnel actually use the military in-house system or CHAMPUS. We understand DOD is represented on the President's Health Care Task Force. It is important that they closely track the proposed reforms and ensure the concerns of DOD are addressed.

* * * * *

As noted in our earlier report, DOD faces an extremely difficult period as it is forced to cut weapons programs, force structure and personnel levels, and realign its support and base structure. Accomplishing these daunting tasks without "hollowing" our forces, treating people unfairly, or undermining future technology programs will take great leadership and skill. If this effort is to be successful, it will require the support of the White House, Congress, and the public. We recognize that the current "bottom-up" review will lead to a new long-term force structure, supporting programs, and financial plan. We hope the Panel's observations and recommendations in our reports will be useful to the Secretary of Defense, his staff, and other key DOD leaders as this process proceeds.



Philip Odeen, Chairman



Jeffrey H. Smith



E. C. "Pete" Aldridge, Jr.



DIRECTOR OF DEFENSE RESEARCH AND ENGINEERING

WASHINGTON, DC 20301-3010

10 FEB 1993

MEMORANDUM FOR CHAIRMAN, DEFENSE SCIENCE BOARD

SUBJECT: Terms of Reference--Defense Science Board Task Force on
FY 1994-99 Future Years Defense Plan

You are requested to organize a Defense Science Board (DSB) Task Force to provide an independent assessment of the management and financial plans of the Department of Defense. The Task Force should review the overall health of the FY 1994-99 Future Years Defense Plan (FYDP) that was prepared by the Bush Administration. It should identify any major management challenges or serious underfunding problems. A final report is requested by March 12.

The DSB Task Force should address the following questions:

- o How accurate are the savings estimates flowing from the Defense Management Review?
- o Are the current estimates of development and acquisition costs for the weapons, sensors and other major systems now in development too low, as has been true historically?
- o What is the size of the potential programmatic overhang (program content in excess of anticipated funding levels) beyond the FY 1994-99 FYDP?
- o Are the FY 1994-99 FYDP funding levels sufficient to support the Base Force and are the projected manpower levels sufficient to man and operate the force?
- o What procedures should the DOD follow to assess the potential for unanticipated liabilities, particularly in the areas of environmental cleanup and health care?

The office of Program Analysis and Evaluation (PA&E) will sponsor this task force. Mr. Philip A. Odeen will serve as Chairman of the Task Force. Mr. David L. McNicol of PACE will serve as Executive Secretary and Mr. John V. Ello will serve as the Defense Science Board Secretariat representative. The office of PA&E will provide funding and other support as may be necessary. It is not anticipated that this Task Force will need to go into any "particular matters" within the meaning of Section 208 of Title 18, U.S. Code, nor will it cause any member to be placed in the position of acting as a procurement official.


Victor H. Reis

MEMBERSHIP

DSB TASK FORCE ON "FY 1994-99 FUTURE YEARS DEFENSE PLAN"

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